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SUBJECT: PANAMA'S PENDING SOCIAL SECURITY CRISIS: A  
CHALLENGE FOR THE INCOMING TORRIJOS ADMINISTRATION

1. Summary. Reforming Panama's actuarially bankrupt social security fund (CSS), which provides pensions, medical services, and workers' compensation to over 60 percent of Panama's population, will be one of the biggest and earliest challenges to face the incoming Torrijos administration. Plagued by increasing claims and decreasing contributions, the system has had to rely heavily upon its reserves, leaving three of its four programs with large deficits. Without reforms to the system, CSS's second largest program, Maternity and Health Services, will exhaust its reserves in three years and CSS's largest program, Disability, Old Age, and Death (IVM), will be bankrupt in an estimated 8-10 years. Most of the major problems stem from current entitlements. For example, men can retire at 62 years and women at 57 years after only 15 years of contributions. Consequently, a Panamanian man who retires will conservatively cost the program over two times what he contributed and a woman approximately four times what she contributed. The incoming Torrijos' administration, set to enter office on Sept. 1, has pledged to fix the CSS but its success will require considerable political will and capital. Indeed, this is a hot-button issue that strikes a populist chord in virtually every sector of Panamanian society. End summary.

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An Overview of the System  
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2. The Caja de Seguro Social (CSS), Panama's social security system, is composed of four programs: (1) the Disability, Old Age, and Death (IVM) program provides pensions to Panamanians who contribute a percentage of their salary for at least 15 years as well as to disabled Panamanians; (2) Maternity and Health services program provides general medical care to Panamanians that register for the system; (3) Professional Risks program provides medical care and pensions for workers injured while on the job; and (4) Administrative program manages the entire system. These programs encompass approximately two million people, or two-thirds of Panama's estimated 3.1 million (2003) population. In 2003, 69.8 percent of Panama's total population were members of the CSS's healthcare system. Of these, 779,000 were active or retired contributors to the CSS and 1.2 million were dependents (i.e., spouses and children of contributors to CSS). Also in 2003, 60.7 percent of Panama's economically active population of 1.25 million were members of the IVM program. Panama's largest public entity, the CSS comprises 20 percent of Panama's total budget and has an annual budget of approximately USD 1.3 billion. It employs 24,000 people; slightly less than half (approximately 10,000) of its workers are doctors, nurses, and technical assistants needed to staff CSS hospitals and clinics.

3. The CSS ended 2003 with a deficit of USD 67,196,177, an increase of over 300 percent from its 2002 deficit. (Note: In 2002, the CSS had a deficit of USD 18,554,363. End note.)

The only program not currently in the red is the administrative program; it finished 2003 with a surplus of USD 5,748,309, a slight decrease from its 2002 surplus of approximately USD 8.5 million. IVM's deficit increased by USD 34,271,779 in 2003 to end at USD 43,693,090. The Maternity and Health Services' program ended at USD 25,791,134, up slightly from its 2002 deficit of 23,516,657. The Professional Risks' program had entered into its first deficit in 2003, to end the year with a loss of USD 3,460,262. At the end of December 2003, the CSS conducted an actuarial valuation of the institutional reserves for the IVM and Professional Risks programs. The IVM had an actuarial deficit of USD 2.78 billion whereas the Professional Risks program had an actuarial surplus of USD 94.54 million.

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What Went Wrong  
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14. The first indications of an impending financial crisis in the CSS were in 1980; this was a direct result of the 1975 political decision to lower the retirement age to 55 for men and 50 for women. Created in 1941, the CSS's original retirement age for both men and women was 60 years of age; the average life expectancy was 64 years in Panama at that time. By 1975, life expectancy had risen to 69 years. Faced with economic challenges because of increased demands to its system in 1980, GOP officials implemented a plan that used the money intended for Panamanian workers as the second payment of the required 13-month bonus and used this money to fund projects designed to add revenue to the IVM. Consequently, Panamanian workers were paid only two-thirds of their mandated 13-month bonus. This measure was repealed in 1983. In 1990, the CSS Board of Directors announced an actuarial deficit of USD 800 million, with the system possibly collapsing in 1996. Partial measures, including increasing the retirement age (62 years for men; 57 years for women) and eliminating anticipated retirements (those by nurses or teachers who may retire after 20 years of service, regardless of age), were passed in 1991 and have helped to extend the life of the system but only by a few years. The GOP does contribute to the CSS but only through an annual set transfer of USD 50 million (or 0.4 percent of GDP); the government does not finance the CSS's below-the-line deficit. The CSS finances its deficit through a reduction in its reserves.

15. The IVM problems present the biggest concern for most Panamanians as it is their only source of retirement income. In 2002, program outflows increased by USD 30.5 million while contributions increased by only USD 5.1 million. This breach continues to widen significantly. These increasing demands are a result of three factors: (1) a higher life expectancy; (2) insufficient contributions to CSS; and (3) limited interest earned on the program's reserves. Increased medical technology and access to medical facilities have caused the average life expectancy to rise to the current 72 years of age for men and 77 years of age for women in Panama. Panamanian law stipulates the retirement age for men to be 62 years of age and women to be 57 years of age. The system has not addressed this increase in demand; by law, Panamanians are required only to contribute to the CSS for 15 years in order to receive a pension. Pensions are not inflation-adjusted. Consequently, retirees are absorbing more money than they have contributed to the CSS. For example, if a man who makes a USD 500 monthly salary contributes to the CSS for 15 years, he will have given the system a total of USD 13,763. He is entitled to receive 60 percent of his salary, or USD 300 a month from CSS. Using a conservative calculation of 7.5 percent interest and 72 years of age life expectancy, he will receive approximately USD 49,763 in benefits, costing the CSS USD 36,000. A woman with the same salary and payment rate will cost the CSS USD 58,237. Finally, Panamanian law requires IVM reserves to be placed in the Banco Nacional rather than faster growing (and arguably more speculative) funds. These sizable reserves earn less than 2 percent in annual interest. While the IVM program maintains the largest deficit, CSS Director of Finances, Benigno Amaya, maintains its reserves and contributions can keep it operational for the next 8-10 years.

16. The CSS's healthcare programs are in severe financial and organizational crisis. Both the Maternity and Health Services and Professional Risks' programs are plagued by inefficient appointment systems, deficient and low quality patient service, and lack of medical supplies. The Maternity and Health Services program's reserves of USD 75 million may only be sufficient for the next three years. Experts also argue that CSS and Ministry of Health (MOH) healthcare efforts are duplicative because both maintain separate healthcare facilities and offer general healthcare services to the public.

17. Lengthy, bureaucratic claims processes and lower pensions associated with the Professional Risks' program have caused additional strain on the Maternity and Health Services program because many workers with minor on-the-job injuries choose to receive care under this program. In general, these patients receive faster service through this fund and higher pensions through the IVM program. The Professional Risks' program only pays a pension equal to 60 percent of the affected's salary; typically, people can earn a higher pension (usually 70 percent) if they contribute more than 15 years to IVM program. As a result, the Professional Risks' program assumes only 10 percent of all healthcare costs incurred by the CSS. It encountered its first deficit in 2003 due to increases in material and supply costs as well as personnel expenses. On average, the Professional Risks' program registers 17,000 cases annually with the majority being serious accidents or illnesses, all easily attributed to on-the-job injuries.

18. Finally, while not technically "in the red," the Administrative program is confronting a number of challenges: obsolete processes and systems, inefficient collection methods, and a seemingly endless payroll. With a workforce of 24,000 and growing, experts contend the CSS could downsize its administrative staff without losing productivity; however, its medical workforce of 10,000 must be maintained or even augmented to continue to provide adequate care.

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Possible Options  
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19. Repairing the CSS will require substantial changes and compromise amongst the three funding entities: the GOP, the employers, and the workers. Technically, in order to reform the system, a proposal must go before the Board of Directors at the CSS for its approval. Once obtained, the proposal is presented to the Executive branch (the President and his cabinet) for its approval. The proposal is then presented to the Legislative Assembly. This body will change or modify the CSS law. The modified law is then sent back to the President for final approval. Once approved, the law enters into force. However, before this process can begin, a consensus on how to reform the system must be achieved. In 2001, President Moscoso created "el Dialogo de la Mesa" or a roundtable working group to assess the CSS's problems and offer solutions.

110. The Dialogue was composed of members of the CSS, GOP, political parties, and civil society (including both employers and labor representatives). Four working groups were created to correspond to the system's four programs. Consensus had to be reached before recommendations were put forth to the GOP. Both the Administrative and Maternity and Health Services programs were able to reach consensus in some areas; the Professional Risks and IVM groups made advances but were unable to achieve consensus on any issue. In December 2003, the Dialogue presented its findings to the Legislative Assembly. The Assembly has not yet taken any steps to implement the group's findings.

111. The Administrative dialogue agreed on the need to modernize current practices and procedures, automate the CSS's information system, improve collection methods, and increase investment returns. These changes would increase transparency and efficiency within the CSS. The Maternity and Health Care Services working group recommended a new national system of health, in coordination with MOH, be adopted. It also recommended a new model of patient care should be adopted, including direct doctor-patient interaction. Finally, this group stated that modernizing and automating the medical records system would be integral to ensuring this program's future success.

112. The Professional Risks' working group made advances on the role of prevention, revisions of benefits, better patient attention, and improved administration. However, the group was unable to reach a consensus on the definition of salary and what benefits, if any, should be included in that definition. While no consensus was reached, the IVM working group made advances on the existence of a problem, some definitions, the use of actuarial tools, and the need to update the program's database. The major source of contention among the group's members remained the key issue of how to finance the deficit.

113. Various proposals to finance the IVM were addressed. Variables at large in these proposals included: the age of retirement, the minimum years required to contribute, the percentage of contribution, the number of years used as a base to calculate pension, the maximum amount of pensions, amongst others. Some options include: increasing the contribution rate, increasing the retirement age, and investing reserves more aggressively. However, most proposals lean heavily toward either the employer or the employee. Neither group has been able to agree on a plan with shared transition costs.

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